



Commodity Futures Trading Commission

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Speech

Speech of Chairman Gary Gensler, Commodity Futures Trading Commission, International Energy Agency

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Good morning. It is a pleasure to be in Paris today with you. Thank you for inviting me to speak at the International Energy Agency on energy futures markets.

Before I turn to regulation of the energy markets, let me explain a little about the Commodity Futures Trading Commission (CFTC), and how we are organized to regulate financial markets in the United States. I also will briefly touch on our efforts to bring regulation to the over-the-counter derivatives marketplace

The CFTC was established in 1974 as an independent financial regulatory agency. The CFTC's predecessor was set up in the 1930s to oversee markets for risk management contracts. The need to regulate the American financial markets arose out of a time of earlier financial crisis. Our nation then responded to the clear need for reform by establishing two market regulators – the CFTC to regulate the markets for risk management contracts, called derivatives contracts, and the Securities and Exchange Commission (SEC) to oversee the securities markets.

The CFTC was initially established to regulate the trading of mostly agricultural futures on commodities such as corn and wheat. Over time, the agency began regulating the trading of energy futures, and ultimately financial products.

The CFTC is charged with a significant responsibility to ensure the fair, open and efficient functioning of futures markets. Our duty is to protect both the market participants and the public from fraud, manipulation and other abuses.

The CFTC does not set prices. The work we do and the policies we implement, however, have meaningful implications on the day-to-day lives of the American people. Futures markets not only provide critical risk management for farmers, producers and other market participants, but they also affect the decisions families make around the dinner table.

Gasoline prices, for example, can determine whether a family takes a summer vacation. Natural gas futures contracts can affect utility bills, and lack of convergence in the wheat market can shorten a grocery list.

It is our job to make certain that futures markets work for the broad public. It is also essential that we ensure fair and orderly markets for investors and hedgers looking to minimize risk.

One year ago, the financial system failed. The financial regulatory system failed. In America, there were gaps in our regulatory structure that left our nation unprepared and unable to respond quickly to changing market environments. While a year has passed since the beginning of the financial crisis and the system appears to have stabilized, we cannot relent in our mission to vigorously address weaknesses and gaps in our regulatory structure. As a critical component of reform, I believe that we must bring comprehensive regulation to the over-the-counter (OTC) derivatives markets. We must lower risk, promote greater market integrity and improve market transparency.

The CFTC is currently working with Congress and President Obama's administration to comprehensively regulate the OTC derivatives markets. This will require two complementary regimes – one for regulation of the banks, or the actors, and one for regulation of the derivatives markets, or the stages.

The banks that deal in derivatives should be required to meet capital standards and margin requirements to help lower risk. These dealers also should have to comply with business conduct standards to promote market integrity by preventing fraud, manipulation and other abuses. To promote transparency, a comprehensive reporting and recordkeeping regime should be established for swaps, including swap repositories.

The markets where derivatives trade also should be comprehensively regulated. We should mandate that all standardized derivative products be cleared by a central clearinghouse to lower risk. We also should improve market transparency and efficiency by moving standardized OTC derivatives onto regulated exchanges and regulated trade execution facilities.

The United States, like the rest of the world, benefits from a regulated market economy. This requires innovation and competition, but also regulation, to ensure that markets are fair and orderly. We will continue to work with international regulators, Congress and the Administration to comprehensively regulate the OTC derivatives markets.

I'd like to now turn to two initiatives that the CFTC has embarked upon related to the energy markets. The first is to promote market transparency, which is a core mission of the CFTC. Earlier this month, we announced two steps to promote transparency. The CFTC has for decades provided the public with weekly Commitments of Traders reports consisting of aggregated data on large-trader positions. I believe that the data categorizations became less relevant as the markets continued to evolve. Historically the CFTC reported the trades of commercial entities and noncommercial entities. Now, for the first time, we are disaggregating swap dealers and managed money (i.e. hedge funds) to more accurately reflect the makeup of the American futures markets. This will give market participants, regulators and the public a better idea of who is participating in risk management markets.

The CFTC also has begun releasing data on index investment in the commodity futures markets. This will inform market participants, regulators and the public about how much involvement index investors have in the derivatives markets. These two steps are part of an ongoing process of looking for ways to best improve transparency in the commodities markets.

Our second initiative is to seriously consider setting position limits in the energy futures markets.

Hedgers – whether they are farmers or oil producers – need somebody else to bear their risk when they enter the futures markets. We call those market participants “speculators.” The CFTC recognizes the importance of speculators to the effective operation of futures markets – markets that benefit the public.

They allow farmers, grain elevator owners, oil producers and oil users to hedge their risk and have a marketplace where prices are determined in a fair and orderly way. If a wheat producer or an oil producer wants to be certain of the price that they will get, or if a utility company wants to be certain of the price of natural gas they will purchase, they need speculators on the other side of the trade. Speculators have been at the heart of the futures markets for more than a century.

While speculators are essential participants, the U.S. Congress long ago recognized that there may be burdens to the economy when the market becomes too concentrated. Congress gave the CFTC an important tool – position limits – and they directed us to use them. The intent is to ensure that market power cannot grow to be so concentrated that it becomes a burden to markets and to commerce.

While we currently set and enforce position limits on certain agriculture products, we do not set them in the energy markets. Instead, the exchanges set energy position limits only in the last three days of trading to address manipulation and congestion. The exchanges, however, are not required by statute to set and enforce position limits to address the burdens of highly concentrated market positions.

There are three reasons why I believe that we should consider position limits in the energy markets. First, our statute mandates it. In 1936, the Congress said that the CFTC “shall” impose limits on trading and positions to guard against the undue burdens that may come as a result of excessive speculation. We are directed by statute to act in this regard to protect the American public.

Second, I believe that position limits should be consistently applied across markets for physical commodities of finite supply. Though there are some differences between energy markets and agricultural markets, I am not sure that those distinctions suggest position limits should be on one and not the other.

One distinction is that the energy markets are larger than the agriculture markets. I believe, however, that we should not regulate the energy markets differently simply because they are bigger. The size of the markets and the effects that they have on the day-to-day lives of the American public make it that much more important that we fulfill our mandate. In fact, until 2001, the CFTC worked along with the American exchanges to set position limits in these markets.

Third, I believe that a key principle in promoting market integrity is ensuring markets do not become too concentrated. Last year's financial crisis highlighted the risk to the market brought about by large concentrated actors on the financial stage.

Position limits can enhance liquidity by promoting more market participants rather than allowing a limited number of parties to dominate a market and possibly decrease liquidity.

As we consider the effects of large, concentrated positions on the markets, our regulations should address times of volatile or uncertain markets as well as when the markets are stable. While things appear to be stabilizing, we must be prepared for the next threat to the American and global financial systems. A key element of this mission is to ensure that no market participant controls such an outsized position that it threatens the integrity of the market.

To effectively regulate the energy markets requires cooperation on the parts of the CFTC, SEC and foreign regulators. We are currently taking steps to achieve this goal. The CFTC and the United Kingdom's Financial Services Authority (FSA) recently agreed to strengthen cross border supervision of energy futures markets. This action built upon the existing cooperative efforts by the two agencies to address cross border oversight of U.S. and U.K. energy markets. Just last week, the CFTC and the FSA also signed a new Memorandum of Understanding to enhance cooperation and the exchange of information relating to the supervision of cross-border clearing organizations. We will continue to work across international borders to best protect and enhance the global financial regulatory system. Additionally, the CFTC and FSA are co-chairing an International Organization of Securities Commissions Task Force on Commodity Futures Markets. This Task Force issued a report last March making a number of recommendations to improve transparency, enforcement and international coordination in the futures markets and is continuing to work on these issues.

It is incumbent upon the CFTC and other regulators to use our existing authorities to promote market integrity and transparency and to guard against fraud, manipulation and other abuses. Thank you for inviting me to speak today on this topic.